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SURREY POLICE

PAPER FOR POLICE AND CRIME COMMISSIONER

Date: 21/07/14

ANNUAL UPDATE OF SURREY GENERAL AND SPECIFIC RESERVES STRATEGY

1. Purpose

1.1.The purpose of this report is to provide an update to the Reserves Strategy for agreement by the Police and Crime Commissioner with advice from the Treasurer. All reserves are under the control and preserve of the Police and Crime Commissioner (PCC) and will remain so subject to some flexibility requested in this paper.

2. Introduction

2.1.This paper updates the General Reserves Strategy which was last approved by the PCC in 2012. The paper sets out the use of general and specific reserves (i.e. earmarked revenue reserves) the latter which are by their very nature, reserves which have been earmarked for a specific purpose. The strategy suggests some change in classification to enable a fuller picture of the reserves maintained. The strategy on specific reserves forms part of the Medium Term Financial Plan which is updated regularly and reviewed by COG / SLT and the PCC.

2.2.In preparing this review of the General Reserves Strategy we have reviewed the legislative and other requirements for the holding of reserves. We have also looked at the Force's current financial position, at current and future risk assessments and at updated benchmarking information on reserve levels in other Forces. We have taken account of the views expressed by the Office of the PCC and considered public opinion, and the reserves levels set out as part of the budget agreed by the PCC for 2014/15 and for the forthcoming four year period. Finally we have taken account of the reduction in central grant and limiting of precept increases over the planning period.

3. Legislation and guidance regarding the holding of a general reserve

3.1.Legislation and CIPFA guidance require that a general reserve is maintained but do not stipulate the level of that general reserve. However, the guidance does require the PCC to consider strategic, operational and financial risk when determining reserve levels with advice from the Treasurer. In addition the Local Government Act 2003 requires the S151 officer (the PCCs Treasurer) to report on the level of reserves annually, the planned usage and the opportunity cost of holding those reserves.

3.2.CIPFA's Guidance Note on Local Authority Reserves and Balances(1) states that a general reserve is required to act as "a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of general reserves". A general reserve is also required to act as "a contingency to cushion the impact of unexpected events or emergencies – this also forms part of general reserves."

3.3.Maintaining a general reserve ensures compliance with the Local Government Finance Act 1992 (2) which states that authorities must "have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement."

4. Factors to consider in deciding on reserve levels

4.1. Overall financial position and adequacy of financial control

- 4.1.1. In setting the level of the general reserve it is important to bear in mind Surrey Police's overall financial position and the adequacy of financial control in operation.
- 4.1.2. The overall financial position has been considered by the PCC as part of the budget process and medium term financial planning, which has taken account of the impact of the government's public sector deficit reduction.
- 4.1.3. It is also important to remember the context of the medium term financial plan agreed as part of the budget process so that the PCC continues to comply with CIPFA's Guidance Note on Local Authority Reserves and Balances which suggests that "Advice should be given on the adequacy of reserves over the lifetime of the medium term financial plan".
- 4.1.4. The use of general reserves does afford the PCC some flexibility in managing the budget over a number of years and there is merit in using reserves in the short term that is backed by a plan to restore those reserves to a set agreed level. For example half a percentage point affords £1m of budget flexibility to the PCC.

4.2. Risk exposure and risk assessment

- 4.2.1. Reserve levels must be considered in the context of risk if we are to comply with CIPFA's guidelines which state that "in order to assess the adequacy of unallocated general reserves.....Chief Financial Officers should take account of the strategic, operational and financial risks facing the Force."
- 4.2.2. Whilst risk exposure and mitigation of that risk may not necessarily drive a material increase in spending, it will influence the level of general reserves year by year.
- 4.2.3. The key risks currently relevant to the level of general reserves now and in the future are;
 - 4.2.3.1. Future Funding Gap – the risk that due to the economic conditions, and real terms reductions in levels of precept and notified reductions in government grant, the increased resource requirements will have a significant effect on already stretched financial resources. These additional requirements may include funding increased contributions for pension schemes, a huge programme of change, including collaboration, to achieve a sustainable financial position. This pressure is likely to impact on operational policing which in turn has an impact on the achievement of targets in the PCCs Policing Plan.
 - 4.2.3.2. Uncertain central funding after 2014/15 due to impending funding formula review, most likely post-election and the continuing commentary from government of further reductions in funding for the non-protected services.
 - 4.2.3.3. The potential for government control of precept increases through the capping regime. Recent years this has been set at no more than 2% with some ministers wishing for that to be lowered.

4.3. Public opinion

- 4.3.1. A key factor in determining a General Reserves Strategy continues to be public opinion. The public's acceptance of the precept is partly reliant on the understanding that the precept is spent on policing and that only a reasonable and prudent amount of any over-funding is being stored away as a General Reserve. Conversely, when unforeseen expenditure arises, such as with Op Franklin response to severe weather conditions, it is likely that the public would expect the organisation to have sufficient resources to cover the expense without recourse to overspend.

4.4. Other police forces reserve levels

4.4.1. The following information is based on the 2013/14 CIPFA Police Statistics Estimates of reserves as at 1 April 2014.

4.4.2. The level of the General Reserve for Surrey Police ranked Surrey 19th out of the 42 Authorities in England & Wales. This is a change from earlier reports which ranked Surrey higher, and relates to our own use of reserves in 2009/10 plus a prudent increase in reserve figures in other forces in face of uncertain economic times and reducing budgets. As a result total General reserves in England and Wales have risen to £392m, 3.7% of total net revenue budgets. Surrey has gradually rebuilt reserves to 5.4% of the net budget.

5. Current general reserve levels and their use

5.1. The forecast level of reserves as at the 31 March 2014 is £11.2m which is 5.4% of the gross budget. A planned increase in reserves of £1.3m will be made in 2014/15.

5.2. The level of a General Reserve is a matter for the Police and Crime Commissioner as advised by his Treasurer (CFO). Percentages of force budgets can be a good comparative however as Surrey has a relatively small budget compared to others, a policy of 3% of budget has been maintained but as this could leave us with a reduced capacity to cope with unforced events, an absolute amount may be regarded as a more prudent approach.

5.3. Use of General Reserves

5.3.1. The use of general reserves assists in the medium term financial planning to mitigate any predicted funding gaps noting that this is a measure that allows a re-phasing of the gap and not a permanent reduction in the base budget.

5.3.2. The use of general reserves does not provide an on-going revenue funding stream to support the revenue account position. However, notwithstanding issues related to risk and medium term planning, it is reasonable to use reserves to fund initiatives in the short term that themselves had on-going positive revenue funding implications. These initiatives are known as “invest to save” options.

5.3.3. The general reserve may also be used to fund capital investment.

5.4. The Force has submitted a request to draw on general reserves to meet additional demand and cost in meeting the requirements as a consequence of a historic case. This is about £1.3m over two years.

5.5. In addition funding to meet the unprecedented level of change to redesign the Force within the forecast reduced budget will be made to the PCC shortly.

6. Specific Reserves

6.1. Reserves are also held to meet specific purposes, they are currently grouped together as “Specific Reserves”, they are included here to allow the full picture to be considered alongside general reserves. The table below sets out the specific reserves held.

Specific Reserves		
	As at 31 March 2014	£m
1	Police Staff Pension Reserve	2.1
2	Employee Retention Reserve	0.9
3	Insurance Self Fund Reserve	3.4
4	Police Officer Ill Health Reserve	1.7
5	Employee Healthcare Reserve	0.3
	Total	8.4

6.2. From the descriptions below it can be seen that the top two specific reserves are to meet a longer term financial issue or require a policy/tactical change and are proposed remain under the full control of the PCC.

6.3. The next three are in place to manage day to day activity and with the PCC maintaining ownership and oversight it is proposed that the Force are permitted to continue managing these reserves in conjunction with advice from the Treasurer.

6.3.1. Police Staff Pension Reserve is an amount established in anticipation of the increased contributions towards the police staff pension scheme and £1.0m is supporting the 2014/15 budget and the balance of £1.1m the following year.

6.3.2. Employee Retention Reserve was established in the recognition of the need for short term retention measures if the employment market changed to cause a loss of staff or an inability to attract staff or police officer recruitment was problematic due to other Forces recruitment activities.

6.3.3. Insurance Self Fund Reserve is a fund to meet anticipated future claims and liabilities that have not crystallised as yet. This amount is reviewed annually by insurance actuaries who are due to report in June/July 2014.

6.3.4. Police Officer Ill Health Reserve is maintained to meet the capital charge made by the Home Office for each officer that retires due to ill health. A percentage of the police officer cost as recommended by the Home Office is added to this reserve and the level will fluctuate from year to year depending on the number of retirees.

6.3.5. Employee Healthcare Reserve is to meet the cost of healthcare interventions, a form of self-insurance, as the premiums for healthcare insurance became unaffordable.

6.4. Operational Reserve.

6.4.1. The Home Office Financial Management Code of Practice for the Police Forces of England and Wales states that the "PCC should establish a policy on reserves in consultation with the Chief Constable, this should have due regard to the need to ensure the on-going funding of policing activities and the requirements to meet exceptional or extraordinary policing operations" and further "ensure the annual budget includes a realistic amount of operational contingency that is available to the Chief Constable for operational priorities without the need for additional approval".

6.4.2. It is proposed that a specific reserve is established for the use of the Chief Constable to meet such exceptional operational requirements. It is suggested this is 0.5% of the annual budget or £1m and is created from general reserves. The reserve once established will require the Force to maintain the balance from year to year from any under spending against the operational budget. The reserve will also replace the previous practice of local balances and the ability to carry forward which is proposed is carried out via this operational reserve. The operational reserve would be for the Chief Constable to control with advice from the Chief Finance Officer. The Force would produce a report that sets out the business case for drawing on the reserve which would be available to the PCC for inspection on request.

7. Risks

7.1. The inability to maintain an adequate general reserve to cover future uncertainties puts the PCC and Force at risk of government sanction and intervention.

8. Decision[s] Required

- 8.1.** The level of a **General Reserve** is a matter for the Police and Crime Commissioner as advised by his Treasurer (CFO). The recommendation is to maintain the general reserve strategy at 3% of the annual revenue budget.
- 8.2.** It is recommended that a Chief Constable **Operational Reserve** is established at 0.5% of the annual revenue budget.
- 8.3.** It is also recommended that **the Specific Reserves**, Police Staff Pension Reserve and Employee Retention Reserve are not accessed without full PCC approval.
- 8.4.** It is also recommended that **the Specific Reserves**, Insurance Self Fund Reserve, Police Officer Ill Health Reserve and Employee Healthcare Reserve are under the control of the PCC and that the Force is allowed to manage them on a day to day basis with advice from the Treasurer.